

(3) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck A (\$2000) over its adjusted basis (\$700), or \$1300. The amount of gain recognized is the lesser of gain realized (\$1300) and the exchange group deficiency (\$715), or \$715.

(4) No property transferred by B was allocated to the residual group. Therefore, B does not recognize gain or loss with respect to the residual group.

(D) The total amount of gain recognized by B in the exchange is the sum of the gains recognized under section 1031 with respect to each exchange group (\$31 + \$0 + \$715), or \$746.

(E) the bases of the property received by B in the exchange (computer R, automobile R, and truck R) are determined in the following manner:

(1) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group (\$800), increased by the amount of gain recognized with respect to that exchange group (\$31), decreased by the amount of the exchange group deficiency (\$31), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$131), or \$931. Because computer R was the only property received within the first exchange group, the entire basis of \$931 is allocated to computer R.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$900), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$346), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$254), or \$1500. Because automobile R was the only property received within the second exchange group, the entire basis of \$1500 is allocated to automobile R.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group (\$700), increased by the amount of gain recognized with respect to that exchange group (\$715), decreased by the amount of the exchange group deficiency (\$715), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$115), or \$815. Because truck R was the only property received within the third exchange group, the entire basis of \$815 is allocated to truck R.

(F) Cash of \$400 is also received by B.

(iii) The tax treatment to C is as follows:

(A) (1) The first exchange group consists of computers R and A (both are within the same General Asset Class).

(2) The second exchange group consists of automobiles R and A (both are within the same General Asset Class).

(3) The third exchange group consists of trucks R and A (both are in the same General Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities of which C is relieved (\$1000) are offset by all liabilities assumed by C (\$500), resulting in excess liabilities relieved of \$500. This excess liabilities relieved is treated as cash received by C.

(1) The first exchange group has an exchange group deficiency of \$100 because the fair market value of computer R (\$1600) exceeds the fair market value of computer A (\$1500) by that amount.

(2) The second exchange group has an exchange group deficiency of \$600 because the fair market value of automobile R (\$3100) exceeds the fair market value of automobile A (\$2500) by that amount.

(3) The third exchange group has an exchange group surplus of \$600 because the fair market value of truck A (\$2000) exceeds the fair market value of truck R (\$1400) by that amount.

(4) The difference between the aggregate fair market value of the properties transferred by C in all of the exchange groups, \$6100, and the aggregate fair market value of the properties received by C in all of the exchange groups, \$6000, is \$100. Therefore, there is a residual group in that amount, consisting of excess liabilities relieved of \$100, which is treated as cash received by C.

(5) The \$400 cash paid by C and \$400 of the excess liabilities relieved which is treated as cash received by C are not within the exchange groups of the residual group.

(C) C recognizes gain on the exchange as follows:

(1) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer R (\$1600) over its adjusted basis (\$1100), or \$500. The amount of gain recognized is the lesser of the gain realized (\$500) and the exchange group deficiency (\$100), or \$100.

(2) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile R (\$3100) over its adjusted basis (\$2100), or \$1000. The amount of gain recognized is the lesser of the gain realized (\$1000) and the exchange group deficiency (\$600), or \$600.

(3) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck R (\$1400) over its adjusted basis (\$600), or \$800. The amount of gain recognized is the lesser of gain realized (\$800) and the exchange group deficiency (\$0), or \$0.

(4) No property transferred by C was allocated to the residual group. Therefore, C does not recognize any gain with respect to the residual group.

(D) The total amount of gain recognized by C in the exchange is the sum of the gains

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recognized under section 1031 with respect to each exchange group (\$100+\$600+\$0), or \$700.

(E) The bases of the properties received by C in the exchange (computer A, automobile A, and truck A) are determined in the following manner:

(1) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group (\$1100), increased by the amount of gain recognized with respect to that exchange group (\$100), decreased by the amount of the exchange group deficiency (\$100), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1100. Because computer A was the only property received within the first exchange group, the entire basis of \$1100 is allocated to computer A.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$2100), increased by the amount of gain recognized with respect to that exchange group (\$600), decreased by the amount of the exchange group deficiency (\$600), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$2100. Because automobile A was the only property received within the second exchange group, the entire basis of \$2100 is allocated to automobile A.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group (\$600), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$600), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1200. Because truck A was the only property received within the third exchange group, the entire basis of \$1200 is allocated to truck A.

Example 5. (i) U exchanges real estate A, real estate B, and grader A (SIC Code 3531) with V for real estate R and railroad car R (General Asset Class 00.25). All properties transferred by either U or V were held for productive use in the respective transferor's business. Similarly, all properties to be received by either U or V will be held for productive use in the respective recipient's business. Real estate R is secured by a recourse liability and is transferred subject to that liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:

	Adjusted basis	Fair market value	Liability
U Transfers:			
Real Estate A	\$2000	\$5000
Real Estate B	8000	13,500
Grader A	500	2000

	Adjusted basis	Fair market value	Liability
V Transfers:			
Real Estate R	\$20,000	\$26,500	\$7000
Railroad car R	1200	1000	

(ii) The tax treatment to U is as follows:

(A) The exchange group consists of real estate A, real estate B, and real estate R.

(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by U (\$7000) are excess liabilities assumed. The excess liabilities assumed of \$7000 is allocated to the exchange group.

(1) The exchange group has an exchange group surplus of \$1000 because the fair market value of real estate R less the excess liabilities assumed allocated to the exchange group (\$26,500-\$7000) exceeds the aggregate fair market value of real estate A and B (\$18,500) by that amount.

(2) The difference between the aggregate fair market value of the properties received in the exchange group (taking excess liabilities assumed into account), \$19,500, and the aggregate fair market value of the properties transferred in the exchange group, \$18,500, is \$1000. Therefore, there is a residual group in that amount consisting of \$1000 (or 50 percent of the fair market value) of grader A.

(3) The transaction also includes a taxable exchange of the 50 percent portion of grader A not allocated to the residual group (which is not of a like kind or like class to any property received by U in the exchange) for railroad car R (which is not of a like kind or like class to any property transferred by U in the exchange).

(C) U recognizes gain on the exchange as follows:

(1) With respect to the exchange group, the amount of the gain realized is the excess of the aggregate fair market value of real estate A and B (\$18,500) over the aggregate adjusted basis (\$10,000), or \$8500. The amount of the gain recognized is the lesser of the gain realized (\$8500) and the exchange group deficiency (\$0), or \$0.

(2) With respect to the residual group, the amount of gain realized and recognized is the excess of the fair market value of the 50 percent portion of grader A that is allocated to the residual group (\$1000) over its adjusted basis (\$250), or \$750.

(3) With respect to the taxable exchange of the 50 percent portion of grader A not allocated to the residual group for railroad car R, gain of \$750 is realized and recognized by U (amount realized of \$1000 (the fair market value of railroad car R) less the adjusted basis of the 50 percent portion of grader A not allocated to the residual group (\$250)).

(D) The total amount of gain recognized by U in the transaction is the sum of the gain recognized under section 1031 with respect to the exchange group (\$0), any gain recognized

with respect to the residual group (\$750), and any gain recognized with respect to property transferred that is not in the exchange group or the residual group (\$750), or \$1500.

(E) The bases of the property received by U in the exchange (real estate R and railroad car R) are determined in the following manner:

(i) The basis of the property received in the exchange group is the aggregate adjusted basis of the property transferred within that exchange group (\$10,000), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$1000), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$7000), or \$18,000. Because real estate R is the only property received within the exchange group, the entire basis of \$18,000 is allocated to real estate R.

(2) The basis of railroad car R is equal to its cost of \$1000.

(iii) The tax treatment to V is as follows:

(A) The exchange group consists of real estate R, real estate A, and real estate B.

(B) Under paragraph (b)(2)(ii) of this section, the liabilities of which V is relieved (\$7000) results in excess liabilities relieved of \$7000 and is treated as cash received by V.

(i) The exchange group has an exchange group deficiency of \$8000 because the fair market value of real estate R (\$26,500) exceeds the aggregate fair market value of real estate A and B (\$18,500) by that amount.

(2) The difference between the aggregate fair market value of the properties transferred by V in the exchange group, \$26,500, and the aggregate fair market value of the properties received by V in the exchange group, \$18,500, is \$8000. Therefore, there is a residual group in that amount, consisting of the excess liabilities relieved of \$7000, which is treated as cash received by V, and \$1000 (or 50 percent of the fair market value) of grader A.

(3) The transaction also includes a taxable exchange of railroad car R (which is not of a like kind or like class to any property received by V in the exchange) for the 50 percent portion of grader A (which is not of a like kind or like class to any property transferred by V in the exchange) not allocated to the residual group.

(C) V recognizes gain on the exchange as follows:

(i) With respect to the exchange group, the amount of the gain realized is the excess of the fair market value of real estate R (\$26,500) over its adjusted basis (\$20,000), or \$6500. The amount of the gain recognized is the lesser of the gain realized (\$6500) and the exchange group deficiency (\$8000), or \$6500.

(2) No property transferred by V was allocated to the residual group. Therefore, V does not recognize gain or loss with respect to the residual group.

(3) With respect to the taxable exchange of railroad car R for the 50 percent portion of grader A not allocated to the exchange group or the residual group, a loss is realized and recognized in the amount of \$200 (the excess of the \$1200 adjusted basis of railroad car R over the amount realized of \$1000 (fair market value of the 50 percent portion of grader A)).

(D) The basis of the property received by V in the exchange (real estate A, real estate B, and grader A) are determined in the following manner:

(i) The basis of the property received in the exchange group is the adjusted basis of the property transferred within that exchange group (\$20,000), increased by the amount of gain recognized with respect to that exchange group (\$6500), and decreased by the amount of the exchange group deficiency (\$8000), or \$18,500. This \$18,500 of basis is allocated proportionately among the assets received within the exchange group in accordance with their fair market values: real estate A's basis is \$5000 ($\$18,500 \times \$5000 / \$18,500$); real estate B's basis is \$13,500 ($\$18,500 \times \$13,500 / \$18,500$).

(2) The basis of grader A is \$2000.

(e) *Effective date.* Section 1.1031 (j)-1 is effective for exchanges occurring on or after April 11, 1991.

[T.D. 8343, 56 FR 14855, Apr. 12, 1991]

§ 1.1031(k)-1 Treatment of deferred exchanges.

(a) *Overview.* This section provides rules for the application of section 1031 and the regulations thereunder in the case of a "deferred exchange." For purposes of section 1031 and this section, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property. In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as

distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See § 1.1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as "other property." For rules regarding actual and constructive receipt, and safe harbors therefrom, see paragraphs (f) and (g), respectively, of this section. For rules regarding the determination of gain or loss recognized and the basis of property received in a deferred exchange, see paragraph (j) of this section.

(b) *Identification and receipt requirements*—(1) *In general.* In the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if—

(i) The replacement property is not "identified" before the end of the "identification period," or

(ii) The identified replacement property is not received before the end of the "exchange period."

(2) *Identification period and exchange period.* (i) The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

(iii) If, as part of the same deferred exchange, the taxpayer transfers more than one relinquished property and the relinquished properties are transferred on different dates, the identification period and the exchange period are determined by reference to the earliest date on which any of the properties are transferred.

(iv) For purposes of this paragraph (b)(2), property is transferred when the property is disposed of within the meaning of section 1001(a).

(3) *Example.* This paragraph (b) may be illustrated by the following example.

Example. (i) M is a corporation that files its Federal income tax return on a calendar year basis. M and C enter into an agreement for an exchange of property that requires M to transfer property X to C. Under the agreement, M is to identify like-kind replacement property which C is required to purchase and to transfer to M. M transfers property X to C on November 16, 1992.

(ii) The identification period ends at midnight on December 31, 1992, the day which is 45 days after the date of transfer of property X. The exchange period ends at midnight on March 15, 1993, the due date for M's Federal income tax return for the taxable year in which M transferred property X. However, if M is allowed the automatic six-month extension for filing its tax return, the exchange period ends at midnight on May 15, 1993, the day which is 180 days after the date of transfer of property X.

(c) *Identification of replacement property before the end of the identification period*—(1) *In general.* For purposes of